

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Johannessen Analyst: Norm Catelli Bill Number: SB 1977
Related Bills: _____ Telephone: 845-5117 Introduced Date: 02/22/2002
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Exempt Transfer of Lake Shastina Mutual Water Company Assets to Lake Shastina Community Services District

SUMMARY

This bill would exempt from taxation any gain related to the transfer of assets from the Lake Shastina Mutual Water Company (Mutual), a private corporation taxed as a cooperative, to the Lake Shastina Community Services District (District), a public agency.

PURPOSE OF THE BILL

According to the author's office, it is beneficial to the citizens of the Lake Shastina community to consolidate the community services, e.g., water, fire, police, sewers, within the District. The purpose of this bill is to facilitate the consolidation of water service by clarifying that the transfer of Mutual's assets to District would not subject Mutual or its shareholders to taxation.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would become effective immediately upon enactment and would be operative for taxable years beginning on or after January 1, 2002.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Internal Revenue Code (IRC) Section 501(c)(12) allows tax-exempt status to "mutual ditch or irrigation companies" which have at least 85% of their income collected solely for the purpose of paying the companies' losses and expenses. In addition, the federal provision also encompasses local benevolent life insurance associations and mutual or cooperative telephone companies.

California does not conform to these federal provisions.

California law allows tax-exempt status to mutual water companies under the homeowner's association exemption in Revenue and Taxation Code (R&TC) Section 23701t. A general qualification of this section is that at least 60% of the gross income of the association or company consists solely of amounts received as membership dues, fees, or assessments from owners of residential units, residences, or lots.

Board Position:

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Department Director

Date

Gerald H. Goldberg

04/02/02

Conversely, a specific qualification that would apply to mutual water companies is the requirement that revenue from metered water may not exceed 40% of the total gross income of the company. This restriction is an element of the 60% test mentioned previously because amounts paid for metered water are considered a payment for consumption of water, and not equalized membership dues, fees, or assessments.

California law generally conforms to federal law regarding corporate liquidations. In a liquidation transaction not involving a subsidiary being liquidated into its parent (so-called "332 liquidations"), generally both shareholders and the corporation will recognize gain on a liquidating distribution (where property, rather than solely cash, is being distributed). The liquidating corporation will recognize gain or loss on the distribution of property in a complete liquidation as if it had sold the property to the recipient, i.e., at fair market value. Amounts distributed to shareholders in a complete liquidation are treated as full payment in exchange for stock, with the shareholder's gain or loss being measured by the amount by which the fair market value of the asset received exceeds (or is exceeded by) the shareholder's basis in the stock.

THIS BILL

This bill would allow Mutual to transfer to District its assets and its obligation to provide service to the company's shareholders, on or before January 1, 2008, in a non-taxable transaction.

The bill also states that the Legislature declares a special statute is necessary because of the unique circumstances of water service in the Lake Shastina area.

The bill also provides that for the one-year period immediately prior to the transfer, 85% or more of the company's income must consist of amounts collected from shareholders for the sole purpose of meeting losses and expenses.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would not significantly impact the department's programs and operations.

LEGISLATIVE HISTORY

AB 1504 (Farr, Stats. 1991, ch. 454) added Chapter 2 (commencing with Section 61850) to Part 7 of Division 3 of Title 6 of the Government Code. Section 61850 of that chapter provides that the transfer of the assets and obligations of the Stonehouse Mutual Water Company to the Hidden Valley Lake Community Services District is not a transfer subject to taxation under the Corporation Tax Law.

OTHER STATES' INFORMATION

Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York laws do not provide an exclusion comparable to the exclusion allowed by this bill. The laws of these states were reviewed because their tax laws are similar to California's income tax laws.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

A revenue estimate requires the disclosure of Mutual's corporate information. The Franchise Tax Board is precluded from providing such information because it is confidential under California Revenue & Taxation Code Section 19542.

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